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September 12, 1997

EX PARTE

BY HAND

William F. Caton
Acting Secretary
Federal Communications Commission
Room 222
1919 M Street, N.W.
Washington, D.C. 20554

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Re: Customer Proprietary Network Information
CC Docket No. 96-115

Dear Mr. Caton:

On September 11, 1997 Alan Gardner (Vice President - Regulatory and Legal Affairs) of The California Cable Television Association, and I met with Dorothy T. Attwood (Attorney Advisor); Jeannie Su (Attorney); Lisa C. Choi (Attorney Advisor); Raelynn E. Tibayan (Attorney); and Tanya Rutherford, of the Policy and Program Planning Division of the Common Carrier Bureau, to discuss to the above-referenced docket.

At the meeting, we discussed the rulings of the California Public Utilities Commission ("CPUC") with respect to Customer Proprietary Network Information ("CPNI") and the relevance of the CPUC's proceedings to the FCC's rulemaking in the above-referenced docket. In this regard, we discussed the use of CPNI by Pacific Bell Communications and Southwestern Bell in their video and telephony marketing efforts and the use of "rewards program" letters, "opt-out" solicitations, and oral telephone pitches designed to elicit customer approval for the release of CPNI where it may not be clear to the customer what he or she is agreeing to permit. CCTA urged the FCC to conclude that such practices are anticompetitive and deceptive and stressed the need for clear, affirmative written approval before a customer's release of CPNI can be deemed knowingly authorized. CCTA also asked the FCC to conclude that CPNI is fully subject to a nondiscrimination requirement, including the obligations of Section 272 (c)(1) and Section 272(b)(5) of the 1996 Act, so that if an affiliate of the incumbent local exchange carrier ("ILEC") obtains CPNI to market non-local services, all other similarly situated independent entities can obtain the information in the same manner. CCTA argued that given the unique

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September 12, 1997
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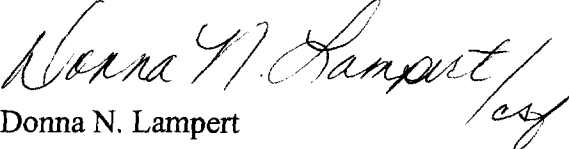
position of the ILECs and their history of previous documented abuses, particularly as found by the ALJ Draft Decision in the Pacific Bell Communications case currently before the CPUC, such a requirement is justified, especially during the transition period set forth in the Telecommunications Act of 1996, so that competition can emerge fully.

CCTA also explained that the study that was submitted by Pacific Bell in a December 11, 1996 ex parte filing is flawed, and should not be accorded weight by the Commission, as the questions are designed to elicit favorable responses rather than designed as neutral inquiries. It was noted in particular that California has an exceptionally strong privacy framework and that Californians are extremely concerned about their personal privacy, with approximately 37-38% of residents requesting unpublished telephone numbers. Further, with respect to the ex parte submission of Professor Lawrence Tribe, CCTA explained that despite any commercial First Amendment protection CPNI "speech" may have, the FCC clearly has jurisdiction to address anticompetitive practices. Finally, CCTA stated that while the requirements applicable to cable operators under Section 631 differ from the requirements applicable to CPNI derived from telecommunications services under Section 222, the standard of Section 222 is reasonable in light of particular Congressional concern about the potential for anticompetitive conduct by the ILECs.

Pursuant to Section 1.1206(a)(1) of the Commission's Rules, two copies of the written documents distributed are attached for inclusion in the public record in the above-captioned proceedings. Due to the lateness of the hour, this Notice is being filed on the following business day. We regret any inconvenience this may cause.

Should you have any questions regarding this matter, please contact me.

Sincerely,

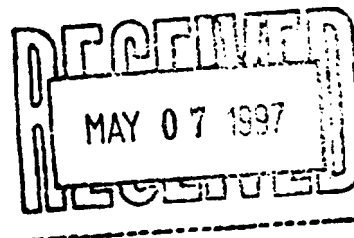

Donna N. Lampert

cc: Dorothy T. Attwood
Jeannie Su
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Tanya Rutherford

PUBLIC UTILITIES COMMISSION

505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298*Case File*

May 5, 1997



TO: PARTIES OF RECORD IN A.96-03-007

This is the proposed decision of Administrative Law Judge Walker. It will be on the Commission's agenda at the next regular meeting 30 days after the above date. The Commission may act then, or it may postpone action until later.

When the Commission acts on the proposed decision, it may adopt all or part of it as written, amend or modify it, or set it aside and prepare its own decision. Only when the Commission acts does the decision become binding on the parties.

Parties to the proceeding may file comments on the proposed decision as provided in the attached section of the Commission's "Rules of Practice and Procedure." Please read them carefully and note the filing dates, the limitations on content of comments, and the requirement of service on all other parties.

/s/ LYNN T. CAREWLynn T. Carew, Chief
Administrative Law Judge

LTC:sid

Enclosure

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Article 19. Decisions, Proposed Decisions, and Commission Meetings

77. (Rule 77) Issuance of Decisions.

A proceeding shall stand submitted for decision by the Commission after the taking of evidence, and the filing of such briefs or the presentation of such oral argument as may have been prescribed by the Commission or the presiding officer.

77.1. (Rule 77.1) Filing Proposed Decision.

The Administrative Law Judge shall prepare a proposed decision, whether interim or final, setting forth the recommendations, findings and conclusions. After discussion with the assigned commissioner, the proposed decision of the administrative law judge shall be filed with the Commission and served on all parties without undue delay, not later than 90 days after submission.

This procedure will apply to all matters which have been heard, except those initiated by customer or subscriber complaint unless the Commission finds that such procedure is required in the public interest in a particular case.

Applicants in matters involving passenger buses, sewer utilities, or vessels may make an oral or written motion to waive the filing of and comment on the proposed decision. Any party objecting to such waiver will have the burden of demonstrating that such filing and comment is in the public interest.

77.2. (Rule 77.2) Time for Filing Comments.

Parties may file comments on the proposed decision within 20 days of its date of mailing. An original and 12 copies of the comments with a certificate of service shall be filed with the Docket Office and copies shall be served on all parties. The administrative law judge shall be served separately.

An applicant may file a motion for an extension of the comment period if it accepts the burden of any resulting delay. Any other party requesting an extension of time to comment must show that the benefits of the extension outweigh the burdens of the delay.

77.3. (Rule 77.3) Scope of Comments.

Except in general rate cases, major plant addition proceedings, and major generic investigations, comments shall be limited to 15 pages in length plus a subject index listing the recommended changes to the proposed decision, a table of authorities and an appendix setting forth proposed findings of fact and conclusions of law. Comments in general rate cases, major plant addition proceedings, and major generic investigations shall not exceed 25 pages.

Comments shall focus on factual, legal or technical errors in the proposed decision and in citing such errors shall make specific references to the record. Comments which

merely reargue positions taken in briefs will be accorded no weight and are not to be filed.

New factual information, untested by cross-examination, shall not be included in comments and shall not be relied on as the basis for assertions made in post publication comments.

77.4. (Rule 77.4) Specific Changes Proposed in Comments.

Comments proposing specific changes to the proposed decision shall include supporting findings of fact and conclusions of law.

77.5. (Rule 77.5) Late-Filed Comments and Replies to Comments.

Late-filed comments will ordinarily be rejected. However, in extraordinary circumstances a motion for leave to file late may be filed. An accompanying declaration under penalty of perjury shall be submitted setting forth all the reasons for the late filing.

Replies to comments may be filed five days after comments are filed and shall be limited to identifying misrepresentations of law, fact or condition of the record contained in the comments of other parties. Replies shall not exceed five pages in length, and shall be filed and served as set forth in Rule 77.2.

77.6. (Rule 77.6) Review of and Comment on Alternates.

(a) For purposes of this rule, "alternate" means either:

(1) a substantive revision to an administrative law judge's proposed decision circulated under Rule 77.1 that materially changes the resolution of a contested issue, or

(2) any substantive addition to the findings of fact, conclusions of law, or ordering paragraphs of an administrative law judge's proposed decision circulated under Rule 77.1.

(b) A revision or addition to an administrative law judge's proposed decision will be considered "substantive" for purposes of this rule if the sponsoring Commissioner determines that the revision or addition is substantive. If the sponsoring Commissioner determines that a revision or addition is not substantive, the President of the Commission in consultation with the Chief Administrative Law Judge may nevertheless determine that the revision or addition is substantive, in which case the President's determination is controlling. The President may delegate this review function to another Commissioner and must delegate it when the President is the sponsoring Commissioner.

(c) An alternate will be filed and served on all parties to the proceeding and, except as provided in subsection (g), will be subject to public review and comment before the

Commission may vote on it. The date of the Commission meeting when the alternate is first scheduled to be considered will be indicated on the first page of the alternate.

(d) If the alternate is served with the administrative law judge's proposed decision, or if the alternate is served at least 30 days before the Commission meeting at which the administrative law judge's proposed decision is scheduled to be considered, the provisions of Rules 77.1 through 77.5 concerning comments on the proposed decision will also apply to comments on the alternate. The page limits of Rule 77.3 apply separately to comments on the proposed decision and to comments on the alternate.

(e) If the alternate is served less than 30 days, but at least 14 days, before the Commission meeting at which the administrative law judge's proposed decision is scheduled to be considered, parties may file comments on the alternate at least seven days before the Commission meeting. The provisions of Rules 77.3, 77.4, and 77.5 on comments on proposed decisions and replies to comments will also apply to comments on alternates and corresponding replies. Comments and replies must comply with Rules 2, 3, 4, and 7. Comments and replies must be served on all parties in compliance with Rule 5, and must be separately served on the administrative law judge and all Commissioners.

(f) If service of the alternate occurs less than 14 days before the Commission meeting at which the administrative law judge's proposed decision is scheduled to be considered, consideration of the proposed decision and the alternate will be rescheduled to a later Commission meeting. Comments on the alternate will be governed by either subsection (d) or subsection (e) of this Rule, depending on the time between the date the alternate is served and the date of the rescheduled consideration of the proposed decision and alternate.

(g) The administrative law judge may waive or reduce the comment period on alternates in an unforeseen emergency situation (Rule 81), and may extend the comment period in appropriate circumstances.

Decision PROPOSED DECISION OF ALI WALKER (Mailed 5/5/97)

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Pacific Bell Communications for a
Certificate of Public Convenience and Necessity to
Provide InterLATA, IntraLATA and Local Exchange
Telecommunications Services Within the State of
California.

Application 96-03-007
(Filed March 5, 1996)

(See Attachment D for list of appearances.)

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OPINION

1. Summary

This decision grants a certificate of public convenience and necessity to Pacific Bell Communications (PB Com), an affiliate of Pacific Bell, to provide long distance service in California upon attaining approval to do so from the Federal Communications Commission (FCC). We grant PB Com's request to withdraw that part of its application seeking authority to operate as a local exchange carrier in competition with Pacific Bell. PB Com also is granted authority to provide local toll service, but we deny for the time being the company's request to be authorized to construct facilities for local toll service. While the FCC permits Bell operating companies to joint market the services of their long distance affiliates, our order today requires that joint marketing by Pacific Bell be done through a separate group of customer service representatives. We also impose an audit requirement to assist PB Com in its compliance with the Commission's affiliate transaction rules. This proceeding is closed.

2. Introduction

PB Com is a California corporation, wholly owned by Pacific Telesis,¹ and is an affiliate of Pacific Bell. PB Com was formed to be the long distance carrier for Pacific Telesis. A separate company is required because the 1996 Telecommunications Act² requires that the entry of Bell operating companies, such as Pacific Bell, into the in-region long distance market must occur through a fully separate affiliate.³ The separate affiliate requirement will expire three years after PB Com begins service, unless the time

¹ By Decision (D.) 97-03-067, a merger of Pacific Telesis Group with SBC Communications, Inc. was authorized. The merger was consummated on April 1, 1997.

² Pub. L. No. 104-104, 110 Stat. 56, 47 U.S.C. §§ 151 et seq.

³ 47 U.S.C. § 272(a)(1).

period is extended by the Federal Communications Commission (FCC), and PB Com at that time presumably could be merged into Pacific Bell.⁴

To begin long distance service, PB Com must obtain authority both from this Commission and from the FCC. In this application, PB Com seeks a certificate of public convenience and necessity under Public Utilities Code § 1001 to provide interLATA, intraLATA and local exchange telecommunications services throughout California.⁵ After hearings, PB Com announced that it was willing to forgo⁶ its request for local exchange authority because, in its view, recent FCC rulings make that authority unnecessary.

PB Com's application is criticized by long distance companies and by two consumer organizations. They argue that PB Com's intended reliance on Pacific Bell to assist the new long distance service must be restricted in view of Pacific Bell's near monopoly status in local exchange service. PB Com argues that it and Pacific Bell must be able to market aggressively if PB Com is to compete against entrenched long distance companies.

⁴ 47 U.S.C. § 272(f)(1).

⁵ "LATA" is an acronym for Local Access and Transport Area. With divestiture of the American Telephone and Telegraph Company in 1984, the territorial United States was divided into 163 geographic units, or LATAs, which in turn were divided among the 22 Bell operating companies created in the divestiture. Telephone calls within a LATA are called local exchange calls or intraLATA toll calls (when a toll is assessed). Telephone calls between LATAs are called interLATA calls.

⁶ For the benefit of those counsel who have relied on computer spell-check programs in drafting their briefs, the word "forgo" means "to relinquish"; the word "forego" means "to go before." Gregg Reference Manual (6th ed.) p. 145.

Most of the evidence in this proceeding has dealt with proposed restrictions on PB Com's new service. According to PB Com, an FCC order issued on December 24, 1996, rules against most of the restrictions.⁷ Opponents disagree, arguing that the FCC order leaves to the states the authority to deal with most of the issues before us in this proceeding.

An overview of the issues and arguments of the parties is set forth in Attachments B and C to this opinion. Attachment B is PB Com's listing of restrictions proposed by other parties, along with PB Com's analysis of the effect of FCC orders on those restrictions. Attachment C was prepared by the consumer organization The Utility Reform Network (TURN). TURN presents what it believes to be the competitive advantages enjoyed by Pacific Bell/PB Com, by AT&T, and by competitive local exchange companies. TURN argues that the competitive analysis shows an overwhelming advantage for Pacific Bell/PB Com and should form the basis for consideration of restrictions on PB Com.

3. Procedural Background

PB Com filed its application on March 5, 1996. Protests were filed by the California Telecommunications Coalition, representing long distance carriers and others;⁸ the Association of Directory Publishers, and the Commission's Division of Ratepayer Advocates, now the Office of Ratepayer Advocates (ORA).

Following a prehearing conference in May 1996, the parties met at the direction of the administrative law judge (ALJ) in an attempt to define and narrow the issues. A

⁷ Implementation of the Non-Accounting Safeguards of Sections 271 and 272, CC Docket No. 96-149, First Report and Order and Further Notice of Proposed Rulemaking (December 24, 1996).

⁸ The Coalition includes AT&T Communications of California, Inc.; California Association of Long Distance Telephone Companies; California Cable Television Association; MCI Telecommunications Corp.; Sprint Communications Co., L.P.; Teleport Communications Group, and TURN (The Utility Reform Network).

further prehearing conference in July led to a schedule for submission of prepared testimony and for hearings.

An early question was whether this proceeding was the proper forum for the Commission to consider whether Pacific Bell has complied with an FCC competitive checklist for unbundling, dialing parity, reciprocal compensation and resale of services to competing carriers.⁹ The Commission is to advise the FCC of Pacific Bell's compliance or non-compliance at the time that PB Com seeks FCC approval to begin long distance service.

On August 9, 1996, the parties were advised by a Managing Commissioner's Ruling that over-all compliance with the competitive checklist would be considered in another forum, drawing participants from the Local Competition and the Open Access and Network Architecture Development proceedings.¹⁰ The ruling stated that the Commission also would consider in that forum Pacific Bell compliance with Public Utilities (PU) Code § 709.2, also known as the Costa Bill.

Notwithstanding the ruling, parties were advised that facts developed in this proceeding would be weighed against requirements of the Telecommunications Act, the Costa Bill and other provisions of the Public Utilities Code.¹¹

Ten days of hearings were conducted between December 2 and December 19, 1996. The Commission heard from witnesses representing PB Com; Pacific Bell; Pacific Telesis; ORA; MCI Telecommunications Corp. (MCI); AT&T Communications of California, Inc. (AT&T); California Cable Television Association (California Cable); Sprint Communications Co., L.P. (Sprint); and TURN. The Commission received 110

⁹ 47 U.S.C. §§ 271(c)(2)(B), (d)(2)(B).

¹⁰ The Local Competition proceeding is Rulemaking (R.) 95-04-043/Order Instituting Investigation (I.) 95-04-044; the Open Access and Network Architecture Development proceeding is R.93-04-003/I.93-04-002.

¹¹ Transcript, Vol. 7, pp. 901-02.

exhibits into evidence, including 46 exhibits which the parties agreed would be sealed because they contained information deemed to be proprietary.

Concurrent opening briefs were filed by the parties on January 31, 1997. Reply briefs were filed on February 14, 1997, at which time the application was deemed submitted for decision. On March 6, 1997, California Cable, AT&T and MCI petitioned to reopen the proceeding to receive a Pacific Telesis declaration and to permit limited additional briefing. By ALJ Ruling dated March 21, 1997, official notice was taken of the declaration and limited briefs were permitted, with the final briefs filed on April 4, 1997.

4. Regulatory Requirements

Federal regulatory requirements for long distance service by an affiliate of Pacific Bell are addressed in § 272 of the Telecommunications Act. Section 272(a) of the Act provides that a Bell operating company such as Pacific Bell may only offer interLATA long distance service in its own region through a separate affiliate. Section 272(b) sets forth structural and transactional requirements applicable to these companies.

Specifically, § 272(b) states that, "The separate affiliate required by this section:

- (1) shall operate independently from the Bell operating company;
- (2) shall maintain books, records, and accounts in the manner prescribed by the [FCC] which shall be separate from the books, records, and accounts maintained by the Bell operating company of which it is an affiliate;
- (3) shall have separate officers, directors, and employees from the Bell operating company of which it is an affiliate;
- (4) may not obtain credit under any arrangement that would permit a creditor, upon default, to have recourse to the assets of the Bell operating company; and
- (5) shall conduct all transactions with the Bell operating company of which it is an affiliate on an arm's length basis with any such transactions reduced to writing and available for public inspection."

Section 272(c) sets forth non-discrimination safeguards applicable to Pacific Bell in its dealings with an interLATA affiliate such as PB Com. Those safeguards state that "a Bell operating company:

- (1) may not discriminate between that company or affiliate and any other entity in the provision or procurement of goods, services, facilities, and information, or in the establishment of standards; and
- (2) shall account for all transactions with an affiliate described in subsection (a) in accordance with accounting principles designated or approved by the [FCC]."

Section 272(e), entitled "Fulfillment of Certain Requests," sets forth four additional provisions applicable to Pacific Bell and PB Com. Those provisions are that a Bell operating company:

- (1) shall fulfill any requests from an unaffiliated entity for telephone exchange service and exchange access within a period no longer than the period in which it provides such telephone exchange service and exchange access to itself or to its affiliates;
- (2) shall not provide any facilities, services, or information concerning its provision of exchange access to the affiliate described in subsection (a) unless such facilities, services, or information are made available to other providers of interLATA services in that market on the same terms and conditions;
- (3) shall charge the affiliate described in subsection (a), or impute to itself (if using the access for its provision of its own services), an amount for access to its telephone exchange service and exchange access that is no less than the amount charged to any unaffiliated interexchange carriers for such service; and
- (4) may provide any interLATA or intraLATA facilities or services to its interLATA affiliate if such services or facilities are made available to all carriers at the same rates and on the same terms and conditions, and so long as the costs are appropriately allocated."

4.1. Costa Bill Requirements

The PB Com application also must be weighed against requirements of the Costa Bill. PU Code § 709.2(c) requires that the Commission, before authorizing interLATA long distance competition in a proceeding like this one, shall have determined:

- (1) that all competitors have fair, nondiscriminatory, and mutually open access to exchanges.
- (2) that there is no anticompetitive behavior by the local exchange telephone corporation, including unfair use of subscriber information or unfair use of customer contacts generated by the local exchange telephone corporation's provision of local exchange telephone service.
- (3) that there is no improper cross-subsidization of intrastate interexchange telecommunications service.
- (4) that there is no substantial possibility of harm to the competitive intrastate interexchange telecommunications markets.

5. Should There Be Restrictions on PB Com Authority?

The primary issue in this proceeding is whether PB Com should be authorized to provide long distance and local toll service with no restrictions beyond those already imposed by this Commission and by the FCC, or whether additional restrictions are necessary to recognize the market power that Pacific Bell enjoys as the provider of virtually all local exchange service and most intraLATA service in its territory.

PB Com argues that it already is constrained by federal and state regulations, and that it needs all of the flexibility it can get to compete with the dominant long distance carriers. Long distance carriers, joined by ORA and TURN, argue that Pacific Bell's marketing power gives the Telesis companies an unfair advantage that, unless constrained, will work to the long-term disadvantage of consumers.

No party questions PB Com's financial and technical competence to provide telecommunications services. Rather, critics of the application challenge the claim of PB Com that its unrestricted entry into the long distance and intraLATA markets will be in the public interest.

6. Position of PB Com

According to PB Com, the evidence in this proceeding demonstrates that competition in the long distance market will benefit from the entry of PB Com. PB Com witnesses testified that the long distance market in recent years has seen increased prices to consumers, despite reductions in access charges that are a major cost factor for long distance service.

PB Com witness Richard D. Emmerson, an economist, testified that the long distance market is not fully competitive despite the presence of more than 100 service providers across the country and the passage of more than 13 years since divestiture. He concluded that "PB Com's entry could very likely improve, perhaps significantly, the economic performance of the interLATA interexchange market." (Ex. 102, at 8-9.)

Robert Sofman, head of marketing for PB Com and a former marketing manager for AT&T, testified that today's national long distance market is dominated by three carriers (AT&T, MCI and Sprint), which collectively control 95% of consumer long distance revenue. He stated that these three carriers also dominate the residential long distance market with 93% of the households. Sofman said that this domination exists despite the presence of hundreds of "niche" competitors because of the major carriers' brand strength and their substantial advertising, attributes which he said PB Com will match. Referring to an AT&T rate increase of 5.9% in November 1996, and smaller increases by MCI and Sprint at the same time, Sofman said:

"I think it's fair to say that...competition is not resulting in downward pressure on price, and I think the recent pricing actions of the three big carriers is evidence that there's not enough vigorous competition to have sustained downward pressure on price." (Transcript, Vol, 4, p. 492.)

Daniel O. Jacobsen, PB Com regulatory director, testified that PB Com intends to supplement the services provided by Pacific Bell, rather than compete for business that otherwise would remain with Pacific Bell, stating:

"It is not our intention to target any of our marketing or do any promotions or do anything that would go after customers that would be better served or ... be inclined to buy service from Pacific Bell."
(Transcript, Vol. 3, pp. 302-303.)

PB Com witnesses emphasized the importance of one-stop shopping, i.e., the ability to offer customers a bundled product of local, local toll and long distance service. They stated that other carriers are offering bundled products today, and that Pacific Bell, when authorized, expects to similarly compete by selling PB Com long distance and local toll services with Pacific Bell's local exchange service.

Sofman testified that PB Com will utilize a variety of marketing techniques, including advertising and direct marketing, but that 50% to 60% of its new long distance customers are expected to come from Pacific Bell sales efforts. Under Commission affiliate transaction rules, he said, PB Com would pay for the time spent by Pacific Bell representatives (at the higher of fully distributed cost plus 10%, or market price) and will pay a 13% commission on sales.¹²

Jacobsen acknowledged in his testimony that Pacific Bell representatives will make use of Pacific Bell subscriber records in selling PB Com services. These records are called Customer Proprietary Network Information (CPNI), and include data related to the quantity, technical configuration, type, destination and amount of use of a subscriber's telephone service. Jacobsen said that no such use of CPNI would be made without first obtaining a customer's permission, that Pacific Bell would use CPNI on behalf of PB Com but would not disclose CPNI to PB Com without written authorization. He testified that Pacific Bell has internal procedures in place to prevent unauthorized use of a customer's confidential records.

¹² PB Com cites the Commission's affiliate transaction rules set forth in Decision (D.) 86-01-026, 20 CPUC2d 237; D.87-12-067, 27 CPUC2d 1, and D.92-07-072, 45 CPUC2d 109.

6.1 Separate Affiliate Status

Under the Telecommunications Act, the long distance affiliate of a Bell operating company must operate independently, maintain separate books, have separate officers and employees, obtain no credit through the Bell company, and conduct all transactions with the Bell company on an arm's-length basis, with transactions reduced to writing and available for public inspection.¹³ Further, in § 272(c) of the Act, Congress directed that a Bell company may not discriminate between its affiliate and any other entity in providing services, facilities and information. In § 272(d), the Act establishes audit procedures to ensure that the Bell companies comply with these requirements.

PB Com witnesses testified that the company has been organized to comply with the federal requirements. Michael Silacci, regulatory director for Pacific Telesis, testified that PB Com also will operate in compliance with this Commission's affiliate transaction rules. He testified that these rules, stemming from Commission decisions in 1986 and 1987 involving other Telesis affiliates,¹⁴ include the following:

- * PB Com will pay the tariff rate for any service from Pacific Bell that is offered under tariff.
- * PB Com will pay the higher of fully distributed cost plus 10%, or a market rate, for any Pacific Bell service not offered under tariff.
- * PB Com will pay a transfer fee of 25% of the annual salary of any Pacific Bell employee transferred to PB Com.
- * PB Com will pay for Pacific Bell sales activities at the higher of fully distributed cost plus 10%, or market rate, and an additional 13% on revenue for a successful sale.
- * Pacific Bell will report to the Commission any pending sale or transfer to PB Com of an asset with a fair market value in excess of \$100,000.

¹³ 41 U.S.C. § 272(b).

¹⁴ D. 86-01-026, 20 CPUC2d 237; D.87-12-067, 27 CPUC2d 1.

- * Pacific Bell will seek advance approval by the Commission on any guarantee of securities or debt obligations for PB Com. (Ex. 55 at 4-6.)

Silacci testified that, given the Commission's current ratemaking treatment of Pacific Bell, in which rates are subject to price caps and essentially frozen, there is no risk that Pacific Bell customers would pay higher prices as a result of services provided to PB Com.

7. Position of ORA

Through its witness, economist Douglas W. Elfner, ORA maintains that restrictions must be imposed on PB Com to prevent it from competing unfairly for long distance business and draining resources from Pacific Bell that could mean deterioration of service or higher rates for Pacific Bell ratepayers. ORA recommends that the Commission apply a ratepayer indifference standard to dealings between Pacific Bell and its affiliate. Specifically, ORA urges the Commission to require that:

- * Pacific Bell fully inform customers on incoming calls of their right to select a long distance carrier of their choice before Pacific Bell markets the services of PB Com.
- * Pacific Bell conduct a market study demonstrating that PB Com services will not financially harm Pacific Bell.
- * PB Com select a different and dissimilar name or be subject to marketing restrictions on calls that it receives that were intended for Pacific Bell.
- * Non-tariffed services provided by Pacific Bell to PB Com be limited to those that are critical or essential.
- * An independent audit of transactions between Pacific Bell and PB Com be conducted to ensure compliance with Commission orders.
- * PB Com be regulated as a dominant carrier rather than a nondominant carrier.
- * PB Com be authorized to provide only those local and/or intraLATA toll services in Pacific Bell territory that it purchases from Pacific Bell.
- * Pacific Bell demonstrate that it is not harmed in the transfer of an employee to PB Com.

In support of these proposals, ORA presented evidence through Elfner intended to show that Pacific Telesis has incentives to subsidize PB Com at the expense of Pacific Bell; that existing safeguards are inadequate to fully protect consumers and competition, that approval of PB Com's application is likely to reduce Pacific Bell revenues and cause its network to deteriorate, and that joint marketing proposed by PB Com may lead to inappropriate affiliate transactions.

Elfner testified that the likelihood of cross-subsidy is increased when one company is regulated because of its monopoly status and a sister company is not regulated. Price cap regulation of Pacific Bell has not eliminated this incentive, he said, adding:

"The CPUC has established an 11.5% benchmark rate of return and a ceiling rate of return of 15% for PacBell. Earnings between the benchmark and ceiling returns are to be split evenly between ratepayers and the Company...PacBell and [the Pacific Telesis Group] have incentives to shift or allocate costs to their regulated operations that would be properly attributed to their competitive ventures so that PacBell may avoid sharing any earnings above the benchmark with ratepayers. Similarly, they have an incentive to shift profits to operations, such as those of PB Com, that may not be subject to any earnings sharing." (Ex. C-64 at 12.)

Elfner stated that existing affiliate transaction rules did not anticipate an application like that of PB Com, where an affiliate would compete with its sister company for intraLATA business. As subsidiaries of a common parent, Pacific Bell and PB Com have a shared objective – to maximize Telesis profits. Elfner testified that Telesis internal documents show plans to "migrate" high value customers from Pacific Bell to PB Com by offering one-stop shopping service. Despite repeated discovery requests, he said, the Telesis Group has provided ORA with no documented projections of toll revenues, customers or net income expected to be lost by Pacific Bell as a result of PB Com's activities. Internal documents also show an intent, he said, to develop new services through PB Com instead of Pacific Bell. Elfner stated:

"By offering such services in PB Com and not PacBell, [Pacific Telesis] would be able to migrate customers requiring those services to PB Com...[U]nder that strategy, those capabilities would apparently be available only to PB Com and its customers, and not to PB Com's competitors, since PB Com is not required to make its services available for resale." (Ex. C-64 at 29.)

Elfner noted that PB Com in its application reserves the right to build its own facilities for local toll services, in addition to purchasing such capacity from Pacific Bell. The risk of facilities-based service, he said, is that Telesis would pump resources into PB Com that otherwise would go to the Pacific Bell system. Competitors would be disadvantaged by such a tactic, he said, since they rely on Pacific Bell facilities for their resold services.

ORA recommends that PB Com be regulated as a dominant carrier, like Pacific Bell, rather than as a nondominant carrier, like all other new long distance companies, citing Elfner's testimony that price floors for PB Com services are necessary to be sure that PB Com services are not subsidized and priced below cost. Without dominant carrier status, or similar restrictions, Elfner testified that PB Com will have the incentive and opportunity to leverage Pacific Bell's market power in its own behalf and to engage in anti-competitive activity.

8. Position of AT&T and MCI

In a joint brief, AT&T and MCI urge the Commission to adopt restrictions on PB Com to curb potential misuse of what they term the "enormous market power" of Pacific Bell. AT&T and MCI witnesses testified that while local exchange markets recently have been opened to competition, entry into that market will be slow. Nina W. Cornell, an economist and former FCC official, estimated that it will be at least five years before most California customers have a choice of facilities-based local exchange carriers. Pacific Bell has 94% of intraLATA local toll residential customers in its service area. AT&T's witness, Nicholas S. Economides, testified that Pacific Bell also enjoys a monopoly in the provision of access service, the service that long distance carriers need from incumbent local exchange carriers to originate and terminate long distance calls.

AT&T and MCI presented evidence showing that most of the officers and a majority of employees of PB Com have transferred from Pacific Bell jobs, and that PB Com has contracted with Pacific Bell for network engineering services. According to the interexchange carriers, the record also demonstrates that Pacific Telesis is coordinating the relationship between Pacific Bell and PB Com, selecting and managing the firms that will provide advertising and conduct market research. Relying on internal Telesis documents, AT&T claims that Telesis has taken an active role in determining the markets that each of its affiliates will pursue.

Cornell testified that because Pacific Bell serves as the administrator for long distance change orders for all carriers in its service territory, the danger of competitive abuse is significant. She testified:

"If joint marketing were to take place in the manner described [by PB Com], Pacific Bell would no longer be providing information on interLATA carriers in a nondiscriminatory manner to end users. This would constitute a very significant anticompetitive abuse of the local exchange bottleneck...To allow Pacific Bell to make...a pitch for PB Com when customers call to establish [local exchange] service, move service, or to change their choice of an interLATA carrier would be a very unfair use of Pacific Bell contacts." (Ex. 67, at 8-9.)

Cornell recommended that Pacific Bell be prohibited from marketing PB Com long distance service on incoming customer calls to establish telephone service, to move service, or to change interLATA long distance carriers. Moreover, she urged that Pacific Bell be instructed not to use customer proprietary records on behalf of PB Com unless it was willing to share those records with long distance competitors of PB Com.

AT&T and MCI witnesses testified that the long distance market in California already is highly competitive, and that entry of PB Com, with corporate costs 15% higher than AT&T's, is unlikely to affect prices on any long-term basis.

Economides urged that PB Com be regulated as a dominant carrier, reasoning that it shares the same ownership and interests of Pacific Bell and "can utilize the near monopoly position of Pacific Bell in the local exchange market for anti-competitive purposes, including vertical price squeezes and cross-subsidization." (Ex. C-72 at 18.)

In this manner, he said, PB Com should be required to price all services above its cost of non-access components, plus the price for access paid by other carriers. PB Com's price floor should be set at the tariffed prices all carriers pay for wholesale local exchange and toll services, plus the total-service long-run incremental costs PB Com incurs for other service components.

The interexchange carrier witnesses also recommended that PB Com be required to follow the more detailed Part 32 Uniform System accounting method, and that it be subject to an annual audit of its affiliated transactions. AT&T and MCI also urged the Commission to require that Pacific Bell's access charges be priced at competitive levels, thus reducing what they termed a principal source of cross-subsidization between Pacific Bell and its long distance affiliate.

9. Position of TURN

TURN, representing residential and small business telephone users, believes that PB Com will contribute little to long-run price relief for long distance service and that its entry into local toll service may actually harm consumers by taking business away from Pacific Bell, which then could seek higher rates to compensate for the loss.

TURN's two witnesses, Regina Costa and Thomas J. Long, testified that Pacific Telesis internal documents show that because Telesis costs are 15% higher than AT&T's, any gains PB Com makes in the long distance market will be based on the market power of its affiliate, Pacific Bell, rather than on competition based on efficiency or lower costs.

In its brief, TURN comments:

"PacBell Comm's public story...is that PacBell Comm will be a separate affiliate that should be treated the same as any other new player trying to break into the interLATA and intraLATA markets. The story also holds that PacBell's customers have no reason to fear any impact on PacBell resulting from PacBell Comm's entry into the marketplace. The applicant also insists that PacBell Comm will be the tonic that the interLATA market needs in order to cure that market's competitive anemia.

"Few cases have underscored as well as this one the value of discovery and cross examination in testing the validity of an applicant's assertions. Simply put, PacBell Comm's cover story crumbled in the face of cross examination and particularly when held up against the 'highly

confidential' internal documents that disclose the [Pacific Telesis Group] family's true intentions....[T]he evidentiary record discloses that PacBell and PacBell Comm will pursue a coordinated effort to exploit PacBell's monopoly power as much as regulators will let them. The record shows that the applicant has no substance to support its feel-good optimism about the impact of its plans on PacBell's financial health. Thanks to the evidentiary hearings, we now know that PacBell Comm's plan for success in the interLATA market depends not on cost or efficiency advantages but on its plan to exploit PacBell's monopoly power." (TURN Opening Brief, pp. 7-8.)

TURN's witnesses attacked the plans by which PB Com would joint market its long distance service by having Pacific Bell customer service representatives seek to sell such service on virtually all incoming calls to Pacific Bell. They stated that Pacific Bell receives tens of millions of calls each year because of its position as a monopoly local exchange carrier, that unrestricted marketing of PB Com on most of those calls would be an abuse of Pacific Bell's monopoly power, and that the planned use by Pacific Bell of customer records on behalf of PB Com would discriminate unfairly against other long distance competitors.

To cure these and other defects, Long made the following recommendations in his testimony:

- * PB Com should be authorized to provide interLATA long distance service, but it should not be authorized to provide local exchange or intraLATA service.
- * If PB Com is permitted to provide local or intraLATA services, such services should be regulated exactly as they would be regulated if they were provided by Pacific Bell. (TURN also supports ORA's recommendation that no facilities-based local or intraLATA service be authorized.)
- * With respect to interLATA long distance service, PB Com should be treated as a dominant carrier and required to establish price floors that are based on total service long run incremental costs.
- * Pacific Bell should be permitted to jointly market PB Com services through mail and outbound telemarketing. On inbound calls to Pacific Bell, joint marketing should be allowed only by a staff separate and distinct from Pacific Bell service representatives. The separate staff should have no more access to

customer CPNI than the marketing personnel of competing long distance providers.

- * Customers should be advised of their rights to deny access to CPNI.

10. Position of ICG Telecom Group

The ICG Telecom Group presented no witnesses at hearing, but it participated in discovery and in cross-examination, and it has filed opening and reply briefs. ICG makes essentially four recommendations:

1. In view of PB Com's decision to continue to seek authority to resell the intraLATA toll services of Pacific Bell, the Commission should take steps to ensure that Pacific Bell does not suffer financial harm through the loss of high value customers to PB Com.
2. In order to ensure that PB Com does not benefit from discriminatory use of CPNI on its behalf by Pacific Bell, the Commission should require Pacific Bell to use a separate staff of customer service representatives when it engages in joint marketing on behalf of PB Com.
3. Based on PB Com's statements that it expects to purchase telecommunications services from Pacific Bell pursuant to tariffed rates, the Commission should prohibit PB Com from buying services or unbundled network elements from Pacific Bell through special contracts.
4. The Commission should recognize that Pacific Telesis will have strong incentives to allocate PB Com costs to Pacific Bell, which then can seek to recover those costs in the "NRF review" and "franchise impacts" cases that the Commission may hear later this year. Accordingly, the Commission should serve notice that it will consider the costs and revenues of Pacific Bell and PB Com as though they were a single firm.

ICG Telecom is particularly concerned that when PB Com acts as a reseller of Pacific Bell's intraLATA toll services, opportunities for shifting costs to Pacific Bell become available (so that costs stay within the new regulatory framework mechanism, thereby limiting Pacific Bell profits and ratepayer sharing), while opportunities for shifting revenues to PB Com are also increased (so that revenues stay outside of the